

Office Market Trends Sacramento

Grubb & Ellis Research

Second Quarter 2006



Vacancy Sinks

Executive Summary

Over 600,000 square feet of net absorption in nearly all of Sacramento's submarkets led to a 90 basis point reduction in the vacancy rate. The positive performance was also aided by the lack of vacant speculative completions logged during the second quarter. Both phenomena are expected to continue through the rest of the year as both new tenant interest and preleasing figures are currently higher than in quarters past.

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Sacramento Office Market Trends

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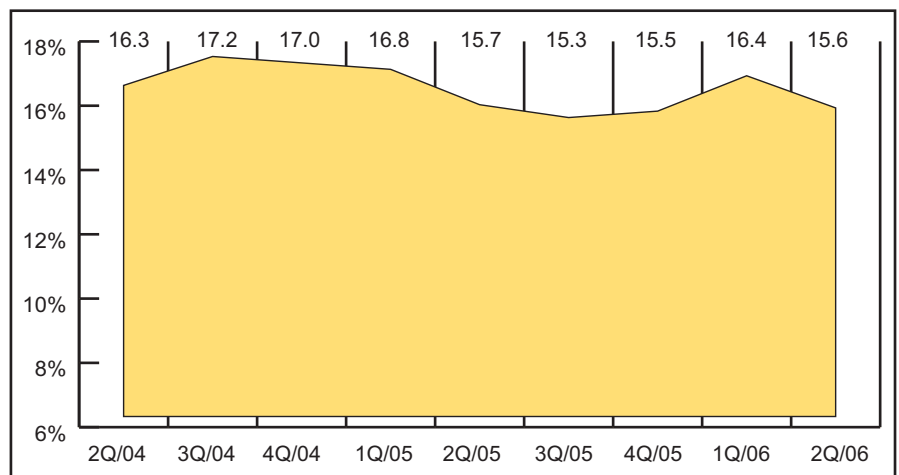
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Average asking rents remained virtually unchanged during the quarter, closing at \$2.11 and \$1.70 per square foot per month full service, respectively, for Class A and B properties market-wide. Average asking rates, however, reflect only the space that is actively being marketed as available. Contract rates on Class A and B deals executed during the second quarter were actually \$2.26 and \$1.64 per square foot, respectively, on average, and are a much better representation of the cost of space in the Sacramento market.

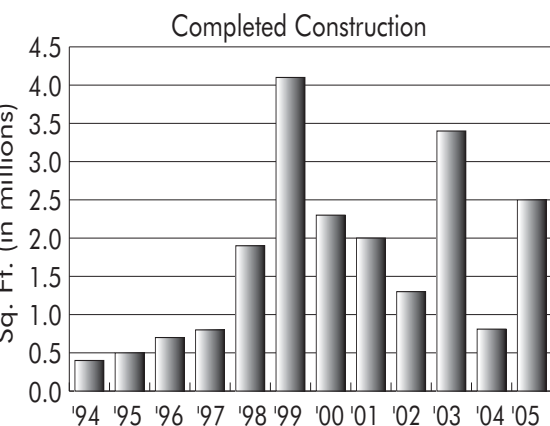
The local economy fared well during the quarter. Latest figures available indicate a 4.3 percent unemployment rate for the four-county MSA at the end of May and an additional 3,800 payroll jobs during the last month, alone. Of note, the residential/commercial construction industry posted an increase of 2,100 jobs in May, presumably due to the rains having ceased and development resuming. Government payrolls grew by 700 jobs during the last month, 200 of the positions in public education. By way of comparison, the state and national unemployment rates were 4.6 and 4.4 percent at the end of May.



Office Vacancy Rate*

* All Classes of Space

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Market Assessment

The local market witnessed an increased amount of activity during the second quarter, as is typical for this time period. All but three of our local submarkets, namely, the Highway 80 Corridor, Roseville/Rocklin and West Sacramento submarkets, posted positive net absorption. Losses in these submarkets were occasioned by tenants vacating large offices in both the Campus Commons and Howe Avenue districts of the Highway 80 Corridor, Creekside Ridge Drive and East Roseville Parkway in Roseville and from Riverside Parkway in West Sacramento. The fact that negative net absorption occurred in Roseville should not be read as a decrease in its popularity. Rather, it is just illustrative of larger tenants moving and not being completely offset by the sum of the smaller deals done in the area.

Moreover, the leasing activity logged during the quarter is expected to be a recurring theme. While the net absorption realized was primarily a result of tenants taking occupancy of space that they leased four to six months ago, the figure should also be viewed as indicative of the increased leasing activity currently in the market. At the end of the second quarter, just over 200 new tenant leads were added to our internal tracking systems. Of note, State agencies contributed nine of these new leads at a total square footage approaching 500,000 square feet. Three of these State requirements also constituted the three single largest tenants on the list.

An appreciable change in new space demands by companies related to residential development has occurred versus this time last year. Their appetite has diminished considerably as the growth trend finally begins to taper off. During the last quarter, health services and medical providers represented the most common use among non-public tenants seeking space. Medical and quasi-medical uses accounted for over 10 percent of the 1.8 million square feet total of new interest noted during the quarter. The legal and financial services fields were also well represented. Also of note, while not universally true, the time between which prospective tenants begin the process of seeking space and their actual occupancy dates are increasing.

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This is illustrative both of the advanced planning and lead time tenants allow en route to securing new space and the length of time required to plan and complete tenant improvements once lease negotiations are complete.

Forecast

While the local market has been characterized by low unemployment and positive job growth, the net absorption logged during the second quarter cannot be fully accounted for by new office hires. More likely, companies having indicated interest in 2005 or executed leases during the last several months have just now taken possession of their offices. As municipal agencies grapple with increased commercial development restrictions and requirements, permitting and planning fees and inspection requirements, the length of time required to complete this process will only increase.

The newer, suburban office submarkets will continue to increase in popularity. Elk Grove, CA, was number one on the US Census Bureau's recently released list of 25 fastest growing cities with populations over 100,000. Further, during the second quarter, the Elk Grove submarket grew by over 100,000 square feet and vacancy witnessed a measurable decrease. There are currently five smaller projects totaling just over 140,000 square feet currently under construction. The Folsom and Natomas submarkets experienced similar growth patterns in their infancies.

It would also appear that the threat of climbing interest rates has come to bear on the perceived beauty of ownership of smaller owner-user buildings and office condo projects, in particular. This demand, having been well received, appears also to have been satisfied to a great degree by developers and a substantial amount of new projects of this type are not expected.

Opportunities and Challenges

With just over 500,000 square feet of net absorption realized year-to-date, it would appear the local market is on track to achieve the 1.2 million square foot net goal stated in January. Maintaining the momentum set during the first half of the year will prove a challenge. Speculation as to the space requirements of new and expanding tenants is an ongoing work in progress, by both landlords and tenants.

Major Transactions

Grubb & Ellis is pleased to announce that we represented the following companies in office transactions during the second quarter of 2006:

ECOM Engineering

\$2.7M user sale
1796 Tribute Rd
Sacramento, CA
B. Barnes, T. Walcott, SIOR

BJLB Enterprises

\$2.6M investment sale
5080 Robert J Mathews Pkwy
El Dorado Hills, CA
J. Rutherford, T. Walcott, SIOR

The Evergreen Co.

10,946 S. F. direct lease
201 Creekside Ridge Ct
Roseville, CA
T. Bacci, D. Neeley, C. Rawlings

Office Market Terms and Definitions

Inventory: Office inventory includes all multi-tenant and single tenant buildings at least 10,000 square feet. Owner-occupied, government and medical buildings are not included.

Construction Type: Speculative ("spec") construction is designed to attract tenants likely to be in the market when the project is leasing. Build-to-suit construction is designed for a specific tenant.

Office Building Classifications: Grubb & Ellis adheres to the BOMA guidelines. Class A properties are the most prestigious buildings competing for premier office users with rents above average for the area. Class B properties compete for a wide range of users with rents in the average range for the area. Class C buildings compete for tenants requiring functional space at rents below the area average.

Vacancy and Availability: The vacancy rate is the amount of physically vacant space divided by the inventory. The availability rate is the amount of space available for lease divided by the inventory.

Net Absorption: The net change in physically occupied space over a period of time.

Asking Rent: The dollar amount asked by landlords for available space expressed in dollars per square foot per month. Office rents are reported as full service where all costs of operation are paid by the landlord up to a base year or expense stop.

Average Weighted Asking Rent: An average market rent where the asking rent for each building in the market is weighted by the building size.

Office Market Snapshot Sacramento Second Quarter 2006

By Submarket (All Classes)	Total SF(1)	Vacant SF (2)	Vacant %	Net Absorption		Under Construction(3)	Asking Rent(4)	
				Current Qtr.	Year-to-date		Class A	Class B
CBD (Downtown)	9,556,724	1,438,254	15.0%	100,419	(157,429)	330,000	\$2.49	\$1.88
Carm/F.O./C.H./O'Vale	1,206,100	50,100	4.2%	19,739	11,537	-	-	\$1.62
Folsom/El Do. Hills	3,199,326	515,402	16.1%	59,769	108,063	217,892	\$2.10	\$1.92
Highway 50	11,927,800	1,744,464	14.6%	323,277	282,842	-	\$1.80	\$1.60
Highway 80	5,802,431	808,905	13.9%	(114,497)	(136,577)	27,750	\$2.10	\$1.66
Laguna/Elk Grove	631,929	175,899	27.8%	124,235	121,894	211,486	\$2.37	\$2.24
Midtown	2,202,605	195,024	8.9%	53,803	55,828	-	\$1.77	\$1.63
Natomas	5,532,606	1,005,884	18.2%	41,688	14,235	293,905	\$1.97	\$1.72
North Sacramento	1,533,577	533,262	34.8%	69,115	69,856	120,000	\$1.55	\$1.34
Roseville/Rocklin	6,176,721	835,510	13.5%	(37,123)	128,351	586,670	\$2.25	\$1.90
South Sacramento	942,047	133,669	14.2%	7,515	27,066	-	-	\$1.55
West Sacramento	1,434,496	374,203	26.1%	(16,473)	(7,055)	-	-	\$1.49
CBD	9,556,724	1,438,245	15.0%	100,419	(157,429)	330,000	\$2.49	\$1.88
Suburban	40,589,638	6,372,322	15.7%	531,048	676,040	1,247,922	\$1.95	\$1.67
Total	50,146,362	7,810,567	15.6%	631,467	518,611	1,577,922	\$2.12	\$1.70
By Class								<u>Available for Sublease</u>
(All Submarkets)								CBD Suburban
Class A	24,801,985	3,529,518	14.2%	472,590	374,051	1,042,642	50,478	348,528
Class B	18,024,546	3,195,893	17.7%	111,515	92,203	535,280	15,524	188,319
Class C	7,319,831	1,085,156	14.8%	47,362	52,357	-	9,767	25,118
Total	50,146,362	7,810,567	15.6%	631,467	518,611	1,577,922	75,769	561,965

(1) Inventory includes multi-tenant and single tenant buildings with at least 10,000 sq. ft.

(2) Vacant space includes both vacant direct and vacant sublease space.

(3) Space under construction includes speculative and build-to-suit for lease projects.

(4) Asking rates are per square foot per month full service. Rates for each building are weighted by the size of the building.

* Grubb & Ellis statistics are audited annually and may result in revisions to previously reported quarterly and final year-end figures.